

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
300 Capitol Mall, 17<sup>th</sup> Floor  
Sacramento, California 95814**

**INITIAL STATEMENT OF REASONS**

**RH01018834  
JULY 2, 2002**

California Insurance Commissioner Harry Low will consider the adoption of amendments to Section 2632.8, Title 10, Chapter 5, Subchapter 4.7, California Code of Regulations. The proposed regulation specifies the method for determining factor weights to be used in calculating premiums for private passenger automobile insurance. The purpose of the proposed regulation is to implement, interpret and make specific the provisions of California Insurance Code Sections, 1861.02 and 1861.05 and to provide for an orderly insurance market.

**DESCRIPTION OF THE PUBLIC PROBLEM**

Proposition 103, which was enacted by the voters on November 8, 1988, required the establishment of a new method of determining premium rates for private passenger automobile insurance. Proposition 103 mandated that premium rates must be established through the use of the following rating factors: the insured's driving safety record; the number of miles driven annually by the insured; and, the insured's number of years of driving experience. These factors are commonly referred to as the "mandatory factors." Insurers are free to use other rating factors that have been adopted by the Commissioner, by regulation, which the Commissioner has determined bear a substantial relationship to the risk of loss. The factors adopted by the Commissioner are commonly referred to as "optional factors." Insurance Code §1861.02(a), as enacted by Proposition 103, requires that the mandatory and optional factors be applied in a specific order and the Commissioner specify a weight for the factors. The existing regulation was promulgated in Department of Insurance File No RH-338 (Section 2632.8 became operative on August 5, 1996).

In determining whether the weight of the optional factors is less than the weight of the mandatory factors, for the purpose of complying with Insurance Code §1861.02(a), the existing regulations compare the average weight for all of the optional rating factors with the weight of each individual mandatory factor. Existing §2632.8 calculates the weight for all of the rating factors by a technique referred to as "the single omit method." Under this method, for every insured vehicle, and for every rating factor – looking at each factor one at a time - insurers calculate the difference between the total premium including the factor under review and the total premium without the subject factor. A large insurer using the single omit method to calculate weight is required to perform millions of calculations. Unless the Department precisely duplicates the millions of calculations required by the single omit method, it is extremely difficult for the Department to determine if an insurance company is correctly complying with the auto rating factor regulations.

The proposed regulation would implement a simplified methodology to calculate the weight of the automobile rating factors. This methodology is designed to achieve the same result as the single omit method and will foster improved regulatory oversight of class plan filings by allowing the California Department of Insurance to more effectively verify that insurers have correctly assigned the weight calculation and rank order to each rating factor.

#### **STATEMENT OF SPECIFIC PURPOSE**

The specific purpose of the adoption of this amendment, and the rationale for the determination that the adoption is reasonably necessary to carry out the purpose for which it is proposed, together with a description of the public problem, administrative requirement, or other condition or circumstance that the adoption is intended to address is set forth below. A comparison with existing Regulations is set forth below.

#### **Section 2632.8**

Insurance Code §1861.02(a) provides that premiums for a private passenger automobile insurance policy are to be determined by the application of the mandatory and optional factors in decreasing order of importance. Subdivision (a)(4) of §1861.02 requires that the optional factors be adopted by regulation and that the regulations set forth the respective weight to be given each factor.

#### **Comparison with existing §2632.8**

Existing §2632.8 calculates the weight for all of the rating factors by a technique referred to as “the single omit method.” Under this method, for every insured vehicle, and for every rating factor – looking at each factor one at a time - insurers calculate the difference between the total premium including the factor under review and the total premium without the subject factor. A large insurer using the single omit method to calculate weight is required to perform millions of calculations. The proposed amended regulation would simplify that process by using summary data that would be representative of the underlying insured vehicles. The proposed regulation would use the percent of exposure and the average premium of each rating factor category to calculate the weight. This data is easier to collect and involves fewer calculations while still preserving the weight that would have been calculated by the Single Omit method. The proposed regulation does not change how the weight of the mandatory rating factors are compared to the optional rating factors for purposes of compliance with Insurance Code §1861.02’s “decreasing order of importance” requirement.

#### **TECHNICAL, THEORETICAL AND EMPIRICAL STUDIES OR REPORTS:**

The Department did not rely on any specific technical, theoretical, or empirical studies or reports in proposing the amendment; however, the Department relied on the technical expertise of its staff.

#### **SPECIFIC TECHNOLOGIES OR EQUIPMENT**

The proposed regulations do not mandate the use of specific technologies or equipment.

#### **LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Proposed regulations do not impose a mandate on local agencies or school districts.

### **ALTERNATIVES**

On January 23, 2002, pursuant to Government Code §11346.45 (a), the Commissioner invited written public comments on three proposals (Alternatives 1, 2, and 3), which he believed would implement a simplified methodology to calculate the weight of the rating factors. The Commissioner specifically requested comments be submitted by February 25, 2002 regarding the advantages and disadvantages of each of the proposals and whether the proposals accomplished the stated goal.

Of the eleven (11) comments received by the Department, four (4) comments supported Alternative 1 (the method adopted in the proposed regulation) because they believed it is easier to use than the single omit method as well as Alternatives 2 and 3; that it would be easier to implement than the other two alternatives; and, that the results of Alternative 1 closely mimic the results of the single omit methodology. Three comments supported Alternative 2 because they believed that it produced results that were more consistent with the single omit method than the other alternatives. Alternative 3 was not favored in any comment because of concern that this alternative would cause instability in premiums due to the erratic nature of loss cost data.

The Commissioner selected Alternative 1 because it is a viable substitute for the more labor-intensive single omit methodology. The changes proposed in Alternative 1 will enable the Department to more easily review and validate the data that is submitted by insurers in their class plan filings. Alternative 1 also the burden of performing the calculations necessary to compute weight. While Alternative 2 more closely replicates the single omit method, the Commissioner rejected this alternative because it would require insurers to submit summary data, which the Department would be unable to verify. The Commissioner rejected Alternative 3 because of the concerns that it would cause instability in premiums.

The Commissioner has not identified any other reasonable alternative that would be more effective in carrying out the purpose for which the regulations are proposed or that would be as effective or less burdensome to affected private persons than the proposed regulations.

### **ECONOMIC IMPACT ON BUSINESS**

To the extent that the proposed regulation makes it easier for insurers to perform the necessary weight calculations, it will have a positive economic impact on business.

### **COMPARABLE FEDERAL LAW**

There are no comparable federal regulations or statutes on the specific problem addressed by the proposed regulations.